

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Nadine Nader

SUBJECT: SEE BELOW

DATE: 1-28-04

Approved



Date

1-28-04

Council District: Citywide

**SUBJECT: LABOR CODE REQUIREMENTS FOR PAYMENT OF WORKERS'
COMPENSATION BENEFITS**

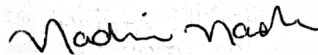
RECOMMENDATION

- (a) Council action on Labor Code requirements for payment of workers' compensation benefits.
- (b) Amend the Council approved Legislative Action Plan by adding the matter of payment of workers' compensation benefits.

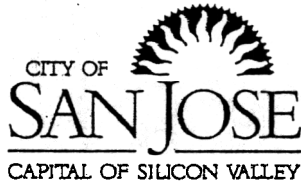
BACKGROUND

At the January 28, 2004 Rules Committee Meeting, the Committee referred the Labor Code requirements for payment of workers' compensation benefits to the February 3, 2004 City Council Meeting for discussion and action.

Please find attached the documents that were presented to the Rules Committee on this topic.


NADINE NADER
Senior Executive Analyst

Rules: 1-14-04 1/28/05
Item: G1
RULES COMMITTEE 12-17-03
ITEM G.1



Memorandum

TO: RULES COMMITTEE

FROM: RICHARD DOYLE
City Attorney

SUBJECT: Proposal re Temporary Disability
Benefits for Police Officers and
Fire Fighters

DATE: December 15, 2003

BACKGROUND

Vice Mayor Pat Dando and Councilmember David Cortese have received a proposal for a Municipal Code amendment that would provide a leave of absence with pay in lieu of disability payments for police officers and firefighters. The Rules Committee has referred the proposal to the City Attorney's Office for an analysis of whether the City has the authority to make such payments in lieu of worker's compensation payments or is preempted by provisions of the California Labor Code. This memorandum is in response to the Committee's referral.

ANALYSIS

A. Current City Practice

When an employee is on disability leave because of a work-related injury or illness, the City pays worker's compensation temporary disability benefits to the employee. Pursuant to the Memoranda of Agreement with the San José Police Officers Association and IAFF Local 230, if the disabled employee is a police officer or fire fighter, the City also pays disability supplemental leave (DSL) pay for up to one year. The DSL pay is the amount of money which, when added to the temporary disability worker's compensation benefits, will provide the police officer or fire fighter payments equal to one-hundred percent of his or her regular salary. After the one-year period, if the employee is still disabled, workers' compensation benefits continue, but the DSL pay stops.

The worker's compensation benefits are excludable from income for federal tax purposes under Internal Revenue Code Section 104(a)(1); no

taxes are withheld when the workers' compensation temporary disability payments are made.¹ The supplemental leave pay is included in income and taxes are withheld from each payment.

B. *The Proposal*

The proposal under consideration is that the San José Municipal Code be amended to provide that when a police officer or fire fighter is disabled because of a work-related injury or illness, the employee will be entitled to "temporary disability payments in an amount equal to his or her regular salary" less amounts deducted for retirement contributions. This payment would not exceed one year or go beyond an earlier date on which the fire fighter or police officer is retired on a permanent disability pension and is actually receiving disability payments.² It is also proposed that the ordinance include a provision that these payments be considered amounts received under workers' compensation acts as compensation for personal injury.

The purpose of the proposed Municipal Code amendment is to have the entire payments "qualify as amounts received under workmen's compensation acts (Division IV of the Labor Code of the State of California) as compensation for personal injuries or sickness and therefore to qualify for certain tax exemptions under the Internal Revenue Service Code", in particular Internal Revenue Code Section 104(a). (See, recitals in proposed ordinance; letters to Randy Sekany from Carol Koenig dated February 25, 2003, and November 5, 2003.)

IRC § 104(a) provides that amounts received under workmen's compensation acts as compensation for personal injuries or sickness are excludable from gross income for federal tax purposes. Section 1.104-1(b) of the U.S. Treasury Regulations provides that IRC § 104(a)(1) excludes from gross income amounts received by an individual under a workmen's compensation act or "under a statute in the nature of a workmen's compensation act" that provides compensation for personal injuries or sickness incurred in the course of employment.

The proposal includes a recital that the Memoranda of Agreement require that the leave not exceed one year or the earlier date that the employee is retired on permanent disability. The current MOAs contain the one-year limitation, but not the retirement limitation so implementation of the proposal would necessitate amendments to the MOAs. In addition, it is not clear how the integration with the Police and Fire Department Retirement Plan would work. Members who retire on disability are subject to recall if they are no longer incapacitated for duty and have not yet reached age 55. (Municipal Code § 3.36.1090.) It is not clear whether the term "permanent disability pension" is limited to those cases where the retiree has reached age 55 or would also apply to retirees who are subject to reinstatement to duty.

C. *California Labor Code Requirements*

Pursuant to its authority under the California Constitution,³ the State Legislature has enacted a comprehensive workers' compensation system that requires employers to secure payment for workers' compensation benefits (either through insurance or by becoming permissibly self-insured) and imposes liability on employers to compensate workers for injury or disability sustained in the course of their employment.

In general, California Labor Code Section 3600 imposes liability for workers' compensation payments on employers, regardless of whether the employer was negligent.⁴ The Labor Code provides that the employer must pay all applicable workers' compensation benefits including costs of medical treatment, temporary disability benefits, permanent disability benefits, and vocational rehabilitation. Thus, when an employee suffers a work-related injury or illness and is off work because of the disability, the City is statutorily obligated to pay temporary disability benefits. There are extensive and detailed formulas for calculating the minimum and maximum temporary disability rates that the City must pay.⁵

If payment of workers' compensation benefits is unreasonably delayed or refused, the employer is subject to a penalty in the amount of ten percent of the full amount of the workers' compensation award. (Labor Code Section 5814.) In addition, an employer who fails to secure payment for workers' compensation benefits is liable both civilly and criminally (if the failure to secure payment was intentional) and the court may impose penalties against the employer and award attorneys' fees to the employee. (Labor Code Sections 3708, 3709.)

A city can enact statutes to provide payments to an injured worker that are over and above the liability imposed by the state (See, e.g., *City and County of San Francisco v. Workmen's Compensation Appeals Board*

³ Cal. Const. Article 14, Section 4 grants "plenary power" to the Legislature "to create, and enforce a complete system of workers' compensation" and "to create and enforce a liability on the part of any or all persons to compensate any or all of their workers for injury or disability" that arises out of the employment.

There are limited exceptions such as where the injury is intentionally self-inflicted or arises out of an altercation in which the injured employee is the initial physical aggressor.

⁵ See, e.g., Labor Code Section 4453. Currently the maximum temporary disability benefit for injuries sustained on or after January 1, 2003, is \$602 per week. In 2004 the rate will go to \$728 per week; in 2005 it will become \$840 per week; and for injuries incurred on or after January 1, 2006, it will be \$840 per week or the highest State average weekly wage.

(1970) 2 Cal.3d 1001), and such statutes will be upheld if the purpose is "to provide additional compensation benefits, **not to supplant or replace the benefits under the Workmen's Compensation Act.**" (*Gilbert v. City of Los Angeles* (1973) 33 Cal.App.3d 1082 at 1087, emphasis added.) But if there is any conflict between a city's charter or ordinances and the provisions of the compensation sections of the Labor Code, the Labor Code takes precedence. "Under power expressly granted to it by the Constitution, the Legislature has expressly established a complete system of workmen's compensation which obviously is a subject of state-wide concern, and it is well settled that in such matters the general law is paramount." (*Healy v. Industrial Accident Commission* (1953) 41 Cal.2d 118 at 122.)

D. Alternative Provisions for Certain Public Employees

There are provisions in the Labor Code that provide an alternative to temporary disability workers' compensation benefits for certain public employees. For city and county safety employees, the alternative provisions are set out in Labor Code Section 4850.⁶

Section 4850 provides that whenever a city police officer or a city, county or district fire fighter who is a member of the California Public Employees' Retirement System or the Los Angeles City Employees' Retirement System or who is subject to the County Employees Retirement Law of 1937 is disabled by injury or illness arising out of and in the course of his or her duties, he or she shall be entitled to a leave of absence while disabled, without loss of salary, in lieu of temporary disability payments or vocational rehabilitation maintenance allowance payments which would be payable under the workers' compensation provisions of the Labor Code.⁷

⁶ Similar provisions cover sworn members of the Department of the California Highway Patrol whose principal duties consist of active law enforcement (Labor Code § 4800.5), California State University Police Department employees pursuant to a collective bargaining agreement (Labor Code § 4816), University of California fire department employees located at a facility maintained by the Regents and who fall in the active firefighting and prevention service class (Labor Code § 4804.1), fire fighters and employees of the sheriff's office in San Luis Obispo County if the Board of Supervisors adopts a resolution (Labor Code § 4850.5), and firefighters employed by a fire district if the governing body of the district agrees that the alternative provisions apply and adopts a resolution to that effect (Labor Code § 4850.7).

⁷ Section 4850 also expressly applies to sheriffs, certain employees in a district attorney's office such as inspectors and detectives, county probation officers and group counselors, lifeguards employed on a year-round basis by certain counties, certain airport law enforcement officers, certain harbor or port police officers, and police officers of the Los Angeles Unified School District as long as these employees are members of CalPERS or LACERS or are subject to the 1937 County Act.

The leave of absence with full pay is limited to one year or until any earlier date that the person is retired on permanent disability pension and is receiving disability payments. If the disability continues for a period beyond one year, the full pay provision no longer applies; the employee continues on the leave of absence but the payments are the statutorily established workers' compensation payments set out in the other provisions of the Labor Code. In addition, both the full pay and the temporary disability workers' compensation benefits cease when the person retires under the CalPERS provisions.⁸

While there are Labor Code provisions similar to Section 4850 that provide leave of absence with full pay in lieu of temporary disability workers' compensation benefits for certain other public safety employees such as California Highway Patrol officers,⁹ there are no such provisions for city safety personnel who are not in CalPERS or LACERS or who are not subject to the County 1937 Act. Thus, local safety personnel who are in other retirement systems are subject to the other workers' compensation provisions of the Labor Code and their employers are statutorily required to make the payments set out in those other provisions.

E. Taxability of Benefits

As noted above, the workers' compensation benefits paid by the City to police officers and fire fighters are excludable from income for tax purposes under Internal Revenue Code Section 104(a).

The California courts have long held that payments made under Labor Code Section 4850 are workers' compensation benefits rather than salary as such. (See, e.g., *Boyd v. City of Santa Ana* (1971) 6 Cal.3d 393, *Hawthorne v. City of Beverly Hills* (1952) 111 Cal.App.2d 723.) Relying on *Hawthorne*, the Internal Revenue Service concluded that the Section 4850 payments are compensation within the meaning of the California workmen's compensation act, and "the fact that the amount received is equal to the employee's salary does not prevent such payments from

Section 4850 benefits are not only integrated with the applicable retirement plan provisions. For example, in *Hupp v. Workers' Compensation Appeals Board* (1995) 39 Cal.App.4th 84, the court found that where the employee had self-employment earnings while on § 4850 leave, the employer was entitled to a credit for those earnings against its obligation to pay the employee's full salary. Under the City's current practice, the City does not take a credit against the disability supplemental leave pay for any outside earnings the employee may receive while on disability leave.

See, footnote 6, above.

being compensation with the meaning of workmen's compensation." (Rev. Rul. 68-10.) Thus, the Section 4850 payments in lieu of other workers' compensation temporary disability payments fall under the scope of Internal Revenue Code Section 104(a) and are excludable from income for federal tax purposes.

But if the statute implementing the payments is neither a workers' compensation act nor in the nature of a workers' compensation act, the payments will not be excludable from income under Internal Revenue Code Section 104(a). (*Brooks v. Commissioner of Internal Revenue*, 1997 WL 786964 (1997).)

There are some local enactments that have been determined to be in the nature of a workers' compensation act. For example, in *Dyer v. Commissioner of Internal Revenue*, 71 T.C. 560 (1979), the United States Tax Court found that payments made pursuant to regulations of the New York City Board of Education to a teacher who was absent from work because of an injury incurred in the line of duty were excludable under Internal Revenue Code Section 104(a). However, the Court relied on the fact that under the statutory law of New York, the Board of Education had the authority and duty to provide workers' compensation for its employees, and teachers in the New York City schools were not covered by any regular workers' compensation act.

Where the employee is entitled to workers' compensation benefits as well as to the additional pay, the additional pay is not excludable from income. (*Gallagher v. Commissioner of Internal Revenue*, 75 T.C. 313 (1980).) For example, if an employee is able to receive an award of permanent disability concurrently with other payments made while the employee is off work because of work-related injuries, those other payments will **not** be excludable under Section 104(a). Thus, in *Blackburn v. Commissioner*, 15 T.C. 336 (1950), the Tax Court held that payments made pursuant to California Labor Code Section 4800 (now 4800.5) to a highway patrol officer who was off work because of injuries suffered in the line of duty were not excludable from income. The Court found that "payments made under section 4800 of the Labor Code are not payments analogous to workmen's compensation but are, on the other hand, a continuation of regular pay during a period of incapacity in a manner similar to any other provision for sick leave, whether or not the employee is involved in hazardous duty." (15 T.C. at 340.)


CONCLUSION

The workers' compensation system is established by the State Legislature pursuant to the Legislature's plenary power under the California Constitution. The purpose of the proposed ordinance is to replace the workers' compensation benefits required under the California Labor Code. However, it is the Legislature, not the City, that has the authority to provide alternative workers' compensation provisions for certain classifications of employees. Implementation of the proposal would require state legislation in the nature of Labor Code Section 4850.

Even if the City were to adopt an ordinance to provide for the disability supplemental leave pay (so the DSL pay would be pursuant to statute rather than the Memoranda of Agreement), the benefits are not likely to be excludable from income. The payments would still be in addition to the workers' compensation benefits the City is required to pay under state law.

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By:


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